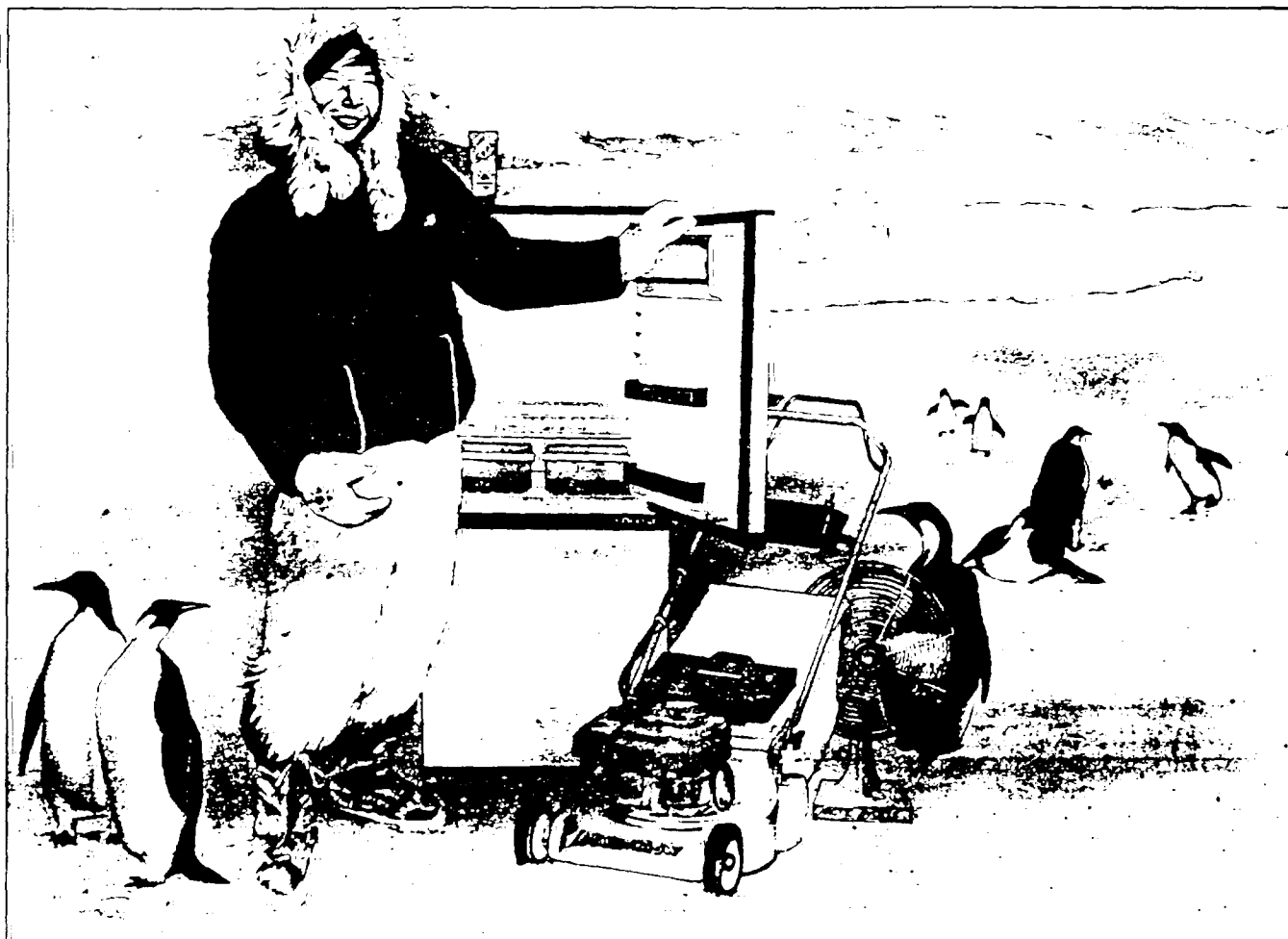


# FRANCHISE

## BUSINESS OF INTERNATIONAL LICENSING

BY LANNING G. BRYER



**L**ICENSING in its simplest terms occurs where a proprietor of rights in a trademark, patent or copyright, not wishing to part completely with his intellectual property right by an outright transfer of title, authorizes the use of that right, on either an exclusive or non-exclusive basis. Generally the licensing of a trademark, patent or copyright stems from a business arrangement between two or more enterprises. Such arrangements are frequently the product of domestic or international trade.

Licensing arrangements in domestic trade can develop where the proprietor is unable, or prefers not, to manufacture the goods himself as a result of his own limited operations or a high demand. Accordingly, the proprietor authorizes a subsidiary or independent manufacturer to produce the goods under licence. Licensing in this case can be very profitable for the owner of the trademark or patent who can

grant the licence in exchange for a royalty fee from the licensee.

Franchising has also made a significant contribution in domestic trade. In the case of a contemporary franchise arrangement, a trademark or trade name is usually licensed by the owner to a licensee, who may or may not be independent of the franchisor/licensor. The licensing of the trademark or trade name permits the affiliated licensee to produce goods or perform services in commercial circles under the particular trademark, service mark or trade name.

In international trade, licensing arrangements can result from several situations. Foreign companies frequently wish to use a trademark, patent or copyright with an international reputation in order to benefit from that reputation without the investment and expense of promoting a new trademark, patent or copyright, and even the largest of companies may find it less

costly to process the goods in a foreign country by utilizing local raw materials and labour. Therefore, rather than establish their own operations abroad, these companies license an independent foreign company to use their trademark on licensed products or services. In addition, foreign concerns often wish to benefit from the know-how, technical processes and techniques of the domestic company and these trade secrets are frequently the subject of a licensing arrangement in connection with the use of trademarks or patents.

### THE LICENSING REVOLUTION

**M**OST systems of law today provide that trademarks may be licensed with the same freedom as patents. However, prior to 1938 many countries considered the licensing of trademark rights unlawful. The passage of the Trade Marks Act of 1938 in

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the United Kingdom marked the start of the licensing revolution by which the United Kingdom and gradually other countries that follow UK trademark law affirmatively permitted the licensing of trademarks. The United States recognized licensing in the Lanham Act of 1946, but the law did not incorporate any requirement of registered user or the registration of licence agreements. Instead, the Lanham Act requires that the proprietor of the trademark control the nature and quality of the licensee's products (15 USC 1055, 1127). Section 1055 of the Lanham Act provides that "where a registered mark or a mark sought to be registered is or may be used legitimately by the lay companies, such use shall inure to the benefit of the registrant or applicant ..." and section 1127 defines a "related company" as "any person including a juristic person who legitimately controls or is controlled by a registrant or applicant for registration in respect to the nature and quality of the goods or service in connection with which the mark is used". Accordingly, the Lanham Act permits a trademark proprietor to license his trademark to anyone, provided that he retains control over the nature and quality of the goods or services in connection with the use of the trademark.

In some Civil Law countries, case law recognized the lawfulness of licensing even before 1938, while in other countries such as France (1857) and Spain (1929) the licensing of trademarks was already lawful under statute.

#### REQUIREMENTS

**N**OWADAYS most countries in the world recognize some form of trademark and patent licensing and many require recordal of licence agreements. The jurisprudence in connection with trademark and patent licensing matters is for the most part divided into two categories. The first group, British Law Countries, are those countries which follow the development of British trademark law and enactment of the "registered user" procedure defined in the UK Trade Marks Act 1938. India, Israel, Australia, Hong Kong and South Africa are among the British Law Countries which provide for registered user entries similar to s.28 of the British Trade Marks Act. If two parties are financially or otherwise related, there is generally no requirement that a trademark licence agreement be filed, but a simple registered user application can be filed, setting forth the terms and conditions of the licensing arrangement.

In the second category, Civil Law Countries, the law can vary widely as to the requirement and procedures of recording trademark, patent and copyright licence agreements. Generally, a certified copy of a licence agreement and, in some cases, an originally executed agreement, need to be submitted, whether or not the parties are related.

#### PROVISIONS OF THE LICENCE AGREEMENT

**O**NCE the idea of a licensing arrangement is agreed on by the parties concerned, a licence agreement should be drafted and executed by both parties, the licensor and licensee. Several elements at the very least should be incorporated into any licence agreement, including, but not limited to, the following:

- The grant of the licence should indicate whether it is to be exclusive or non-exclusive and, if it is exclusive, whether the licence also prohibits the proprietor/licensor from marketing the licensed products in the territory and using the trademark or service mark.
- In the case of an exclusive licence, a provision as to whether the licensee may manufacture or sell competing products should be included. While this may be a restrictive covenant, it is often permitted if the licensee gains an advantage as a result of an exclusive licence (see Stephen P. Ladas, 'Problems of Licensing Abroad', (1966) 56 Trademark Reporter 492.)
- Provisions establishing control by the trademark or patent proprietor over the user, including
  - compliance with the standards and specifications furnished or approved by the patent or trademark owner;
  - a right of inspection of the licensee's premises, manufacturing processes and finished products; and
  - a right to receive samples of the licensed products.
- A provision as to whether a licensee has the right to assign the licence or grant a sublicense. Generally, the agreement should provide that no assignment or further licence is permitted without the prior written approval of the licensor.
- Provisions regarding termination or expiration of the licence, the option of renewal, and clauses for which licensor or licensee may cancel the agreement prior to expiration of the term. Such clauses may provide for termination based on
  - non-compliance with any or specific clauses of the agreement;

- termination with or without prior notice;
- termination in the event of the licensee's bankruptcy, insolvency or assignment of rights for the benefit of his creditors; and
- termination due to the prevention of performance that goes beyond the control of the parties (ie *force majeure* or as a result of governmental action).

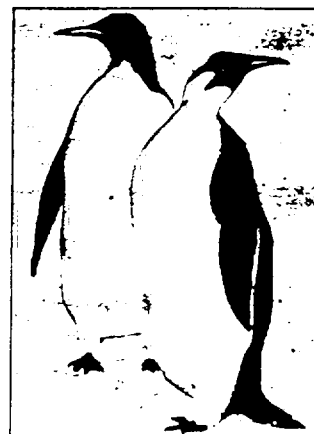
● In the event that royalty fees are included in the licence arrangement, provisions should be inserted detailing

- the time and amount of payments;
- definition of the net sales against which the royalties are to be calculated;
- an undertaking by the licensee to keep accurate and complete accounting records, as well as permitting the licensor the right of inspection.

● A clause providing that, in the case of an infringement, an action shall be at the discretion of the licensor, and that any litigation shall be under the full control of the licensor. However, an option can be included providing that the action may be brought at the sole discretion of the licensor, in the name of the licensee.

● Provisions specifying the choice of law that shall govern the interpretation and construction of the licence.

The most important provisions in the agreement relate to the degree and manner of control by the intellectual property owner over the licensee in order to insure that the licensee's products or services are similar in nature and quality to those manufactured or performed by the owner so as not to confuse or mislead the public. Accordingly, it is not sufficient merely to provide for a right of inspection and receipt of samples of the licensed products as mentioned above. The trademark owner should consciously maintain an active file of inspection and verification of the licensee's products and services. ▷



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## PRECISION DRAFTING

**P**ARTIES should take care that the terms and conditions comprising the agreement between them be specifically and clearly indicated in the agreement. For example, the licensor can grant a sole or exclusive licence. The difference is that, under a sole licence, use of the intellectual property right can only be made by the licensor and licensee while, under an exclusive licence, the licensee has been given an exclusive right to use the intellectual property right, exclusive even as to the licensor unless expressly provided for otherwise. However, rather than rely on general definitions of these concepts and to eradicate any possibility of ambiguity, the licensor should state the terms specifically in the agreement as to whether or not the licensor is permitted to use the intellectual property right. This issue should not be left open to subsequent interpretation.

Furthermore, it is essential to identify clearly the intellectual property right which is the subject of the agreement as well as the nature of the goods or services that are being licensed. If possible, registration or application numbers should be utilized for identification, and specimens of relevant trademarks should be attached to the agreement as exhibits.

## APPROVAL OF LICENCE AGREEMENTS

**Q**UITE a substantial number of foreign countries will require governmental approval of licence agreements in order to record the agreement at their patent or trademark office. This requirement most frequently exists where the licensor is a foreign company, the licensee a national company, and provisions in the agreement exist providing for the remittance of royalties out of the country. Government agencies also examine the agreement for restrictive clauses or provisions that violate their local antitrust laws.

In Mexico (a Civil Law jurisdiction), for example, all technology transfer agreements are subject to approval by the Department of Technology, Development, Patents and Trademarks and they must be registered with the National Registry of Technology Transfer (NRTT). Until recently, 3% of net sales was generally considered the maximum royalty on domestic sales; now officials will allow higher rates, in some cases as high as 10%, if they feel that the technology contributes to Mexico's specific development goals (see *International Licensing & Trade, Mexico*

June 1984 13). In addition, many provisions are prohibited under Article 15 of the Mexican Law on the Control and Registration of the Transfer of Technology and Exploitation of Patents and Trademarks (effective February 11, 1982). Agreements which are unacceptable include clauses

- involving the transfer of technology freely available in Mexico;
- establishing excessively long terms (10 years is considered a maximum);
- setting a price that is out of proportion to the technology sold;
- permitting the licensor to interfere with the management of the licensee;
- requiring the licensee to keep technical information secret at the termination or expiration of the agreement and
- requiring the licensee to sell products to an exclusive client.

In Venezuela (a Civil Law jurisdiction), licence agreements must be approved by and registered with the Superintendency of Foreign Investments (SIEI) in order to be valid. Thereafter, the agreement must be recorded at the Industrial Property Office in order to prevent possible cancellation of the licensor's Venezuelan trademark registration for non-use, since use by a recorded licensee inures to the benefit of the licensor. Royalty and fee patterns vary, but a rate of 5% net sales can be considered a practical maximum. Usually, a maximum of 1% is allowed for a trademark and 4% for a patent and technical assistance (see *International Licensing and Trade, Venezuela*, March 1986 12). Decision 24 and National Decree 746 of 1975 list restrictive clauses that must be eliminated from existing agreements and may not be included in new agreements. Specifically, Venezuelan law prevents the inclusion of any clause that compels the use of specific quality controls in order to exploit the technology (Decree 746 of 1975, Article 1 (d)); prohibits the manufacture or sale of products on the basis of the licensed technology after expiration of termination of the agreement (Decree 746 of 1975, Article 1 (a)); compels the licensee to pay local taxes on the licensor's royalties and fees (Decree 746 of 1975, Article 1 (h)); and reserves for the licensor the right to determine the sale or resale prices of the licensed products used in connection with the trademark (Decree 24 of 1974, Article 20(b), 45(c)).

As a final example, in India (a British law jurisdiction), any agreement that involves remittances of royalties and fees must be reviewed by the Reserve Bank and

the Foreign Investment Board (FIB). Patent licence agreements must be recorded at the Indian Patent Office to be valid; however, the recording of a registered user agreement involving trademarks, though optional under the law, is recommended in order to insure that use by the user inures to the benefit of the proprietor. All technology transfer agreements involving a foreign party are subject to government approval. Clauses generally unacceptable in this jurisdiction include those which

- provide for payment of a minimum guaranteed royalty to licensor;
- require the domestic licensee to purchase goods, components or raw materials from one source, and
- restrict free export to foreign countries.

In addition to careful examination of agreements by governmental agencies, royalties and fees are subject to close scrutiny and the Indian government makes every attempt to keep them low.

- "For patents on food, drugs or medicine, under which compulsory licences are granted, the Patents Act set a legal maximum of 4% of sales as royalties. For other items, the general rule of thumb used by the government is that royalties, technical fees and the rest should not constitute more than 7-8% of the ex-factory sales". (*International Licensing & Trade, India*, October 1985 20).

## REGISTRATION OF LICENCES

**R**ECORDING licence agreements is frequently an essential procedure in the licensing of an intellectual property right. As already discussed above, in Mexico, recordal at the NRTT is mandatory. Failure to record the agreement will render the agreement void and unenforceable at law. Several other countries such as Peru, Colombia and the USSR, like Mexico, have strict rules of mandatory registration, while in other countries such as the Federal Republic of Germany and Switzerland, the recording of trademark licences is not possible.

At the present time, in addition to the United Kingdom, the law of most British law countries provides for the independent recording of a trademark licence agreement under the registered user procedure. The registered user procedure in many of these British law countries permits a registered user application to be filed simultaneously with a trademark application which is based on the proposed use by the user. Countries whose laws are modelled

upon Section 29(1)(b) of the UK Trademark Act 1938, provisions for simultaneous filing of Trademark and Registered User applications are as follows:

COUNTRY	TRADEMARK ACT SECTION No.
AUSTRALIA	45(1)(b)
BOPHUTHATSWANA	24(1)(b)
BRUNEI	17(b)
CANADA	39(2); 49(5), (7), (8)
CYPRUS	30(1)(b)
GUYANA	31(1)(b)
GHANA	29(1)(b)
HONG KONG	18(1)(b)
IRELAND	37(1)(b)
JAMAICA	31(1)(b)
KENYA	32(1)(b)
MALAWI	34(1)(b)
MALAYA	19(7)(b)
MALAYSIA	26(1)(b)
NEW ZEALAND	38(1)(b)
NIGERIA	35(1)(b)
PAPUA NEW GUINEA	35(1)(b)
SABAH	19(7)(b)
SARAWAK	17(b)
SEYCHELLE ISLANDS	26(1)(b)
SINGAPORE	11(7)(b)
SOUTH AFRICA	24(1)(b)
SOUTH WEST AFRICA	24(1)(b)
TANGANYIKA	32(1)(b)
TRANSKEI	24(1)(b)
TRINIDAD & TOBAGO	43(1)(b)
UGANDA	32(1)(b)
VENDA	24(1)(b)
ZAMBIA	34(1)(b)
ZIMBABWE	34(1)(b)

In addition, should the proprietor of the trademark be financially related to the user so as to own a controlling interest in the company, a trademark licence generally need not be submitted in support of the registered user application. Instead, in most circumstances, a declaration attesting to the relationship between the parties will be enough to allow the registered user to be approved and entered.

While a registered user entry can be independently obtained in the countries listed above, several British law jurisdictions, including Antigua, Belize, British Virgin Islands, Falkland Islands, Gibraltar, Granada and Montserrat, only permit entry of a registered user which has been extended from a registered user entry already obtained in the United Kingdom.

The law of many Civil Law jurisdictions also provides for the independent recording of licence agreements. In some Civil Law countries such as Japan a trademark licence may be

recorded against a pending trademark application; however, many Civil Law countries require a trademark registration to be obtained prior to the recording of the licence agreement. Submission of an original or certified copy of the licence agreement is generally required in Civil Law countries whether or not the parties are financially related.

In several Civil law and British Law countries licensing is recognized and recordation is optional but advisable for a variety of reasons. In France, for example, a licence agreement must be recorded to be effective against third parties (Article 21(2) of Decree No.65-621 of July 27, 1965). Use of a trademark by a recorded licensee protects the validity of the trademark from attack by a third party based on cancellation for non-use. In addition, a trademark licence must be recorded against each concerned trademark registration. The mere fact that a trademark registration is cited in any agreement will not be enough to obtain the protection against third parties. In Austria, Brazil and Sweden, recordation of a trademark licence is advisable to insure that use by the licensor inures to the benefit of the trademark proprietor, which in most cases is the licensor. In many jurisdictions, trademark user requirements exist which mandate that commercial use of a trademark be made within a prescribed period to avoid exposing the trademark to abandonment or cancellation for non-use. Use by a recorded licensee in many countries will satisfy the user requirement, since the licensee's use is deemed to be that of the proprietor.

## MAINTENANCE OF LICENCE AGREEMENTS

**S**PECIFIC additional steps may be required within many jurisdictions, even once recording of the licence agreement has been completed at the respective governmental authority to preserve the registration of the licence. For example, in Mexico, annuity payments on each trademark, patent and technology transfer agreement must be paid each year, in order to prevent the registration from lapsing. Brazilian trademark practice requires that, each time a trademark is renewed, the corresponding licence must be re-recorded. In Turkey, the Certificate of Registration must be endorsed with registration of the licence each time the trademark is renewed. Accordingly, proper record-keeping procedures and practices should be instituted to insure that licence registrations remain valid and subsisting.

In general, foreign patent laws require payment of annuities during the life of the patent as well as working obligations. The requirement that a patented invention must be utilized within the country will usually be satisfied by the licensee commencing working of the patent; however, certification of such working may be required to be submitted to the Patent Office.

## CONCLUSION

**T**HE field of licensing is a highly useful and lucrative alternative to exploiting one's product, service or process oneself within the intellectual property field. It is an alternative which should be given serious consideration by practitioners, intellectual property right owners and individuals, companies or corporations seeking to develop new markets based on already well-established reputations of particular trademarks, trade names, patents or copyrights. Aside from making good commercial sense to the proprietor of the intellectual property right as evidenced by significant royalty fees, licensing can substantially improve the commercial viability of the technology involved, which in turn will increase the value of the property right. Moreover, in addition to the commercial benefits derived from licensing, consideration should be given to the legal requirements, as outlined above, in order properly and completely to protect an intellectual property right. □

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